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In the Supreme Court of the United States

October Term, 1938

Guy T. Helvering, Commissioner of Internal Revenue, petitioner

v.

Robert C. Winmill

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

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CITATIONS

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OPINIONS BELOW

The opinion and dissenting opinion in the Board of Tax Appeals (R. 8–16) are reported in 35 B. T. A. 804. The opinion of the Circuit Court of Appeals (R. 35–38) is reported in 93 F. (2d) 494.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 13, 1937 (R. 38–39). The petition for a writ of certiorari was filed March 12, 1938, and was granted April 11, 1938 (R. 39).

The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a taxpayer who is engaged in the business of buying and selling securities for his own account may deduct, as an ordinary and necessary business expense, brokerage commissions paid in the purchase of the securities, or whether such commissions represent a part of the cost of the securities.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> (a) EXPENSES.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *
>
> * * * * *
>
> (r) LIMITATION ON STOCK LOSSES.—
>
> (1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

SEC. 111. DETERMINATION OF AMOUNT OF GAIN OR LOSS.

(a) COMPUTATION OF GAIN OR LOSS.—Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b), and the loss shall be the excess of such basis over the amount realized.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) BASIS (UNADJUSTED) OF PROPERTY.—The basis of property shall be the cost of such property; * * *

* * * * *

(b) ADJUSTED BASIS.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) GENERAL RULE.—Proper adjustment in respect of the property shall in all cases be made—

(A) for expenditures, receipts, losses, or other items, properly chargeable to capital account, including taxes and other carrying charges on unimproved and unproductive real property, but no such adjustment shall be made for taxes or other carrying charges for which deductions have been taken by the

taxpayer in determining net income for the taxable year or prior taxable years;

* * * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 103. *Inventories at cost.*—Cost means:

* * * * *

(2) In the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

* * * * *

ART. 121. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 141–272. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 55.) Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the

trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 122), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, accident, or other similar losses in the case of a business, and rental for the use of business property. A taxpayer is entitled to deduct the necessary expenses paid in carrying on his business from his gross income from whatever source. As to items not deductible, see section 24 and articles 281–284.

ART. 282. *Capital expenditures.*—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23 (k) and article 201.) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. *Commissions paid in purchasing securities are a part of the cost price of such securities.* Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * * [Italics supplied.]

STATEMENT

During the year 1932 respondent operated three separate securities trading accounts (R. 9). During that year he sold 61,992 shares of stock through the three accounts, the cost of which to respondent was $2,884,531.14, exclusive of purchase commissions. The 61,992 shares were sold by respondent in 1932 for $2,722,904.37. Of the purchase commissions on the 61,992 shares, which amounted to $8,911, respondent paid $7,493.50 in 1932 (R. 9–10).

At the end of the year 1932 respondent had on hand in his individual trading accounts shares of stock on which purchase commissions in the amount of $403 were paid by him in that year. This amount is not included in the purchase commissions above described (R. 5, 10).

In his return for the year 1932 respondent claimed a deduction of $172,771.02 as losses on the sale of stocks (R. 9). In the audit of the return the Commissioner, relying on Section 23 (r) (1), *supra*, p. 2, disallowed the claimed deduction for stock losses and also refused to allow, as an alternative, the purchase commissions as a deductible expense (R. 6–7).

The Board of Tax Appeals sustained the Commissioner on both grounds (R. 8–15). It made no finding as to whether respondent was engaged in the business of buying and selling securities in 1932, since it believed that in any event the commissions were not deductible (R. 12–14). The Circuit Court of Appeals, holding that the commis-

sions were a business expense, ordered that the case be remanded to the Board for a finding on whether respondent was engaged in the business of buying and selling securities in 1932 (R. 38). Earlier in its opinion the court had stated that the evidence would justify such a finding (R. 37).[1] The petition for certiorari sought a review of the decision only so far as it related to the commissions paid on the purchase of shares of stock, in the amount of $7,896.50 ($7,493.50 plus $403).[2]

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a taxpayer engaged in the business of buying and selling securities for his own account is entitled to deduct from gross income, as an ordinary and necessary business expense, brokerage commissions paid in the purchase of securities.

2. In failing to hold that brokerage commissions paid in the purchase of securities represent a part of the cost of such securities.

3. In reversing in part the decision of the Board of Tax Appeals.

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[1] The mandate of the Circuit Court of Appeals was not stayed. On December 31, 1937, the Board of Tax Appeals, pursuant to the remand, found as a fact that respondent was engaged in the business of buying and selling securities in 1932.

[2] The petition (p. 3) erroneously gives the total as $7,763.50 ($7,493.50 plus $270).

SUMMARY OF ARGUMENT

The Commissioner, in refusing to allow respondent to deduct brokerage commissions paid on the purchase of securities incident to a trade or business, followed the specific directions of Treasury Regulations 77, Article 282, which requires that such expenses be capitalized. The same requirement has appeared in every regulation since 1916, and must now be taken to have the force of law. Moreover, it has received judicial approval, and it is in accord with the principle that amounts paid in the acquisition of property are to be treated as a part of its cost.

The holding of the court below that Article 282 is limited by Section 23 (a) of the statute and Article 121 of the Regulations, promulgated under that section, is erroneous, for it is an obvious attempt to make a general regulation control a specific one. Moreover, general provisions similar to that of Section 23 (a) have been in the various Revenue Acts for many years, and hence the specific requirement of Article 282, which has been confirmed by Congress, must control.

The alternative holding below that Section 23 (r), which limits deductions for "non-capital" losses, deprives of force the reenactment of the statute in 1932, is also erroneous. That section changed only the consequences of the classification of expenditures as capital outlays or business expenses, not the classification itself, and was not, in

fact, a complete change even of consequences.

Moreover, even if Article 282 did not obtain a ratification by the reenactment of the statute in 1932, it is still in effect, and Section 23 (r) certainly does not so change the statute as to warrant a holding that the regulation is void. On the contrary, it seems plainly correct.

ARGUMENT

The sole issue in the present case is whether a taxpayer engaged in the business of buying and selling securities for his own account may deduct brokerage commissions paid in the purchase of securities as an ordinary and necessary business expense under Section 23 (a) of the Revenue Act of 1932, *supra*, p. 2, or whether they must be treated as a part of the cost of the securities. If they are treated as a capital expenditure, they simply increase respondent's loss on stock sales—a loss which he has not been allowed to deduct by reason of Section 23 (r) (1), *supra*, p. 2. If they be treated as a business expense, they may be deducted, since respondent had other income (R. 9).

The action of the Commissioner in treating these purchase commissions as capital expenditures, rather than business expenses, was based upon the clear mandate of Article 282, Treasury Regulations 77, *supra*, p. 5. That article provides in part as follows:

> Commissions paid in purchasing securities are a part of the cost price of such securities.

The regulation is clearly applicable and expressly denied the contention of the respondent.

Nor can its validity now be open to question. The regulations issued under the Revenue Act of 1916 stated that purchase commissions on securities were a part of the cost of the securities, and did not constitute expense deductions. See Art. 108, Treasury Regulations 33 (Revised, 1918). The same rule has been carried forward since that time, in substantially the same language, in every set of regulations dealing with income taxes that have been issued.[3] During that time the income tax has been constantly amended, deductions have been widely and frequently changed, and the very section of the statute under which this regulation was issued was amended three times prior to 1932, the year here involved.[4] It would be difficult to find a

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[3] Art. 293, Treasury Regulations 45 (1918); Art. 293, Treasury Regulations 62 (1921); Art. 292, Treasury Regulations 65 (1924); Art. 292, Treasury Regulations 69 (1926); Art. 282, Treasury Regulations 74 (1928); Art. 282, Treasury Regulations 77 (1932); Art. 24–2, Treasury Regulations 86 (1934); Art. 24–2, Treasury Regulations 94 (1936).

Since 1932, the regulations have been modified somewhat with regard to brokerage commissions paid on the sale of securities. That issue is not before this Court. In any event, that modification was applicable only to *dealers* in securities. See G. C. M. 15430, XIV–2 Cumulative Bulletin 59.

[4] Article 108, Regulations 33 (Revised, 1918) was issued under Section 5, Revenue Act of 1916 (c. 463, 39 Stat. 756). In the Revenue Act of 1918 (c. 18, 40 Stat. 1057), various items not deductible were gathered into Section 215. That section (which became Section 24 in the Revenue Act of 1928 and subsequent Acts) was itself twice amended: in the Revenue Act of 1921 (c. 136, 42 Stat. 227), by the addition

clearer case in which to apply the rule that Congress, by recension of the statute, must be presumed to have adopted its administrative interpretation, such that the regulation now has the force of law. *Old Mission Co.* v. *Helvering,* 293 U. S. 289, 294; *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466; *Hassett* v. *Welch,* 303 U. S. 303, 312.

Moreover, the regulation has received consistent judicial approval. In *Hutton* v. *Commissioner,* 39 F. (2d) 459 (C. C. A. 5th), the court, in approving and applying the regulation, pointed out (p. 460) that "It has been a settled rule of the Treasury Department that commissions paid in purchasing securities are a capital expenditure * * *." In *Helvering* v. *Union Pacific Co.,* 293 U. S. 282, this Court tacitly approved the regulation here in question. The Court held that commissions paid by a taxpayer upon its own bonds were not deductible as an expense in the year of issue, but should be amortized over the life of the bonds, and said (p. 286):

> In this respect the commissions do not differ from brokerage commissions paid upon the

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of Section 215 (b) and in the Revenue Act of 1928 (c. 852, 45 Stat. 791) by the addition of Section 24 (c).

Since 1932, the section has again been twice amended, with no indication that Congress was dissatisfied with the Commissioner's treatment of purchase commissions on securities. See Revenue Act of 1934 (c. 277, 48 Stat. 768), Sec. 24; Revenue Act of 1938 (Public No. 554, 75th Cong., 3d Sess.), Sec. 24.

> purchase or sale of property. The regulations have consistently treated such commissions, not as items of current expense, but as additions to the cost of the property or deductions from the proceeds of sale, in arriving at net capital profit or loss for purposes of computing the tax.

A footnotes to the opinion (Note 3, p. 486) cited the successive regulations, including Article 282 of Treasury Regulations 77, which the court below refused to apply.

Finally, the requirement that brokerage commissions paid in the purchase of securities be capitalized is in accord with the well-recognized principle that any amount paid in the acquisition or defense of title to property is a capital expenditure and is properly to be considered as a part of its cost. *Helvering* v. *Union Pacific Co.*, *supra*; *Bonwit Teller & Co.* v. *Commissioner,* 53 F. (2d) 381 (C. C. A. 2d), certiorari denied, 284 U. S. 690; *Spinks Realty Co.* v. *Burnet,* 62 F. (2d) 860 (App. D. C.), certiorari denied, 290 U. S. 636; *Hutchings* v. *Burnet,* 58 F. (2d) 514 (App. D. C.); *Commissioner* v. *Chicago Dock & Canal Co.,* 84 F. (2d) 288 (C. C. A. 7th).[5] The regulations have, from the beginning, consistently so provided. See, *e. g.,*

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[5] Cf. *Beneficial Industrial Loan Corp.* v. *Handy*, 92 F. (2d) 74 (C. C. A. 3d), affirming 16 F. Supp. 110 (Del.); *Houston Natural Gas Corp.* v. *Commissioner*, 90 F. (2d) 814 (C. C. A. 4th), certiorari denied, 302 U. S. 722; *Baltimore & Ohio R. Co.* v. *Commissioner*, 78 F. (2d) 460, 463 (C. C. A. 4th); *Moynier* v. *Welch*, 97 F. (2d) 471 (C. C. A. 9th).

Article 103 (2), Treasury Regulations 77 (1932); Article 1613 (2), Treasury Regulations 69 (1926); Article 1582 (1), Treasury Regulations 45 (1918). See also Montgomery, *Auditing—Theory and Practice* (2d ed.), p. 383; Kester, *Accounting—Theory and Practice,* Vol. II, p. 282; I. T. 2433, VII-2 Cumulative Bulletin 130. In *Bonwit Teller & Co.* v. *Commissioner, supra,* it was held that commissions paid to secure a lease should be capitalized and deducted ratably over the life of the lease. The court likened the commissions to a fee paid a broker for negotiating an annuity contract and stated (53 F. (2d) at p. 384) that such a fee "would pretty clearly be a capital expenditure to be added to the cost of the annuity rather than a business expense for the year when paid." There appears to be no essential difference between a brokerage fee paid in the acquisition of an annuity contract and one paid in the acquisition of securities.

We submit, therefore, that Article 282 of the Regulations not only properly interprets the statute, but has also acquired, by the consistent reenactment of the section under which it was promulgated, a standing which may not now be questioned. Since it expressly comprehends the present case, the position of the Commissioner should be affirmed, and the decision below reversed.

The court below, in denying this contention, apparently sustained alternative arguments. First,

it held that Article 282 of the Regulations is modified by Section 23 (a) and Article 121, so that, properly interpreted, the regulations themselves sustain respondent rather than the Commissioner. Second, and in the event that Article 282 be considered applicable, the court held it to be erroneous, and not to be given weight as a consistent administrative construction of the statute because of the addition of Section 23 (r) to the statute in 1932. These arguments will be discussed in that order.

1. The argument that Article 282 is inapplicable to respondent rests upon the assumption that it is limited, in some fashion, by Section 23 (a) of the Act, *supra*, p. 2, and Article 121 of the Regulations, *infra*, p. 4, promulgated thereunder. Section 23 (a) allows the deduction of ordinary and necessary expenses involved in carrying on any trade or business. Article 121 provides, in part:

> Among the items included in business expenses are * * * commissions, * * *.

This, the court below held, authorized the deduction.

The difficulty with the argument is that it is obviously an effort to make a general regulation, which incidentally mentions "commissions," control a specific one, which requires that commissions paid in the purchase of securities be capitalized. That, of course, may not be done. Article 282 states, in language as clear as words can make it, that commissions paid in purchasing securities are a part of the cost of the securities. General language

elsewhere in the regulations can obviously not create an exception to that rule. Both the courts and the Board have denied that such an exception existed. *Hutton* v. *Commissioner, supra; I. N. Burman,* 23 B. T. A. 639, 643.

Moreover, to the extent that the decision below rests upon an interpretation of Article 121 which overrides Article 282, it is contrary to the Treasury's consistent interpretation of those provisions. And where the question is as to the proper construction of a Treasury regulation, the Treasury's own interpretation over a long period of years is the best evidence of what it intended the regulation to mean.

The argument based upon the general effect of Section 23 (a) might have some force but for the fact that some similar provision has existed in all the Revenue Acts. See, *e. g.,* Revenue Acts of 1921, 1924, Section 214 (a). Consequently, even on the assumption that Section 23 (a) could, in the absence of administrative construction, be construed to allow the deduction of purchase commissions paid in the course of a trade or business, the consistent reenactment of the statute without the express grant of a deduction expressly denied by the regulations must be taken as conclusive evidence that Section 23 (a) is not to be interpreted as a limitation on the provisions of Article 282. *Old Mission Co.* v. *Helvering; United States* v. *Dakota-Montana Oil Co.,* both *supra.*

2. Alternatively, the court below seems to have decided (R. 38) that whatever force may be attributed to prior reenactments of the Revenue Acts without modification of the rule of Article 282, the reenactment in 1932, the year applicable here, is of no effect because of the addition, in the Revenue Act of that year, of Section 23 (r), *supra*, p. 2. Of course, the fact that the reenactment of the statute did not constitute an approval of the regulation would not destroy its validity, and the article is still applicable to respondent whether or not it has been affirmatively approved. The court below, however, seems to have taken the further step, and held Article 282 to be a misinterpretation of the 1932 Act which need not be followed in the present case.

We believe the court erred in both respects: Section 23 (r) allows the deduction of losses from the sale or exchange of stocks which are not capital assets only to the extent of the gains from such sales or exchanges. When such gains are absent, as in the present case, purchase commissions which have been added to cost of securities will simply increase a loss which is not deductible. There is no reason to suppose, however, that Congress, simply by changing the *consequences* of a classification of expenditures as capital outlays, intended to modify the well-established classification itself. Indeed, the more reasonable inference is that it did not intend any modification, else it would have been at

pains to announce it. Cf. *United States* v. *Dakota-Montana Oil Co.*, 288 U. S. 459, 466-467.

Actually Section 23 (r) did not work such a drastic change as respondent would have the Court believe. It is true that under that section a taxpayer might never have the benefit of a deduction of purchase commissions unless the sale of "non-capital" assets results in a profit, but even under prior Revenue Acts the requirement that purchase commissions be capitalized entailed a similar possibility. If securities were sold at a loss and no taxable income existed against which the loss might be taken in the year of sale, the commissions would serve no function in reducing taxable income, which they might have done had they been treated as a business expense in the year in which the securities were acquired. The hazard is increased by Section 23 (r), but a hazard existed under prior Acts. Bearing in mind the fact that deductions are a matter of legislative grace, *New Colonial Ice Co.* v. *Helvering*, 292 U. S. 435, 440, no great weight can be attached to the fact that the possibility of obtaining the benefit of a deduction has been decreased.

Moreover, even on the assumption that Section 23 (r) removes the effect of the reenactment of the statute, the court below seems completely unjustified in holding the regulation to be erroneous. As we have pointed out, *supra*, pp. 11-12, the regulation has received consistent judicial approval. *Helver-*

ing v. *Union Pacific Co.,* 293 U. S. 282, 286; *Hutton* v. *Commissioner,* 39 F. (2d) 459 (C. C. A. 5th). It is consistent with the administrative and judicial treatment of brokerage commissions paid upon the purchase of other property. See p. 12–13, *supra.* In fact, during the twenty years in which the Treasury Department has been requiring that purchase commissions on securities be capitalized, no court or Board decision has even intimated that the rule was erroneous. Under those circumstances, we submit, a regulation which *classifies* expenditures cannot be held void and of no effect simply because a change in the statute decreases the possibility of obtaining the benefit of a deduction if the classification remains in effect.

Finally, the conclusion that Section 23 (r) did not effect a change in the treatment of purchase commissions is reinforced by the unfairness that a contrary conclusion may bring to a much larger group of taxpayers than that in which respondent finds himself, namely, those who purchase securities in transactions not related to the prosecution of a trade or business. Hitherto, under the position asserted by the Government, such commissions have been added to cost and are revealed on the ultimate disposition of the securities. Now, however, the court below has classified purchase commissions as current expenses, rather than items of cost. If the decision below be affirmed, such commissions could not properly be added to cost; nor,

in the usual case, would they even be deductible as "expenses", because not incurred in a "trade or business". It is not to be presumed that Congress intended such far-reaching consequences to flow by implication from Section 23 (r).

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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